STATE OF CALIFORNIA
FRANCHISE TAX BOARD – Legal Department
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TO: **********

November 6, 2003

SUBJECT: **********

Dear **********:

Your letter of ********** has been assigned to me for response. Review of your letter indicates that you are requesting a Chief Counsel Ruling on behalf of a group of related entities referred to collectively in your letter as **********. More specifically, you are requesting a ruling that the employer, as defined under traditional common law rules, constitutes the qualified taxpayer for purposes of determining which member of an affiliated group is entitled to both the Enterprise Zone and Los Angeles Revitalization Zone hiring credits.

FTB Notice 89-272 identifies and discusses the guidelines for requesting a ruling from the Franchise Tax Board. It is the policy of the Franchise Tax Board, when appropriate and in the interest of sound tax administration, to respond to inquiries from taxpayers about their status for tax purposes and the tax effects of their acts or transactions. The Franchise Tax Board, however, may decline to issue a ruling or opinion, whenever warranted by the facts and circumstances of a particular case. In this case, a Chief Counsel Ruling cannot be issued as the ruling you requested requires analysis of a series of factual issues and is based upon a presumption that *** ********** are the common law employers of the individuals included in the leasing arrangement between the parties.

While we will not be issuing a Chief Counsel Ruling because of the nature of the inquiry, we can provide a brief discussion of the issues that may arise when attempting to determine the employer for purposes of the hiring credits. You should be aware that this is being provided to you for informational purposes only, and may not be considered "written advice from the Board" within the meaning of Revenue and Tax Code ("RTC") section 21012. You should also be aware that our response is subject to change in cases of change in relevant statutory authority, judicial or administrative case law, or federal interpretation of federal law, upon which our discussion is based.

FACTS PRESENTED

********** is a staff leasing company that provides employees to an affiliated corporation known as **********. In your letter of **********, you provide a series of facts in an attempt to shed further light on the relationship between the parties involved in this arrangement, including:

1) ***** remits the payroll taxes imposed by FICA on behalf of the leased employees.
2) Leased employees are required to comply with ***** work instructions.
3) Leased employees are integrated into ***** business operations.
4) Leased employees and *** have a continuing relationship.
5) *** sets and controls the leased employees work hours.
6) Leased employees' work exclusively for ***.
7) Leased employees' work on the premises of ***.
8) *** furnishes tools, materials and other equipment to the leased employees.
9) **** has the right to discharge the leased employees.

In addition to the facts detailed above, you have also stated that ***, and not ****** has invested significantly in the facilities at which the leased employees do their work, and that it is *** who bears the risk of profit or loss as a result of the employee's services. You also make it clear that *** has established locations within the enterprise zones that qualify for the hiring credits.

THE LAW

California Revenue and Tax Code section 23622.7(a) provides that:

> There shall be allowed a credit against the "tax" (as defined by Section 23036) to a taxpayer who employs a qualified employee in an enterprise zone during the taxable year.

California Revenue and Tax Code section 23622.7(b)(5) provides that:

> "Taxpayer" means a corporation engaged in a trade or business within an enterprise zone designated pursuant to Chapter 12.8 (commencing with Section 7070) of Division 7 of Title 1 of the Government Code.

While the statute provides the parameters for the allowable credit, it does not provide specific guidance as to what entity is considered the "employer" when dealing with a situation that involves leased employees. As you pointed out in your letter, the only written guidance on this issue is contained in the California Franchise Tax Board Economic Development Areas Manual ("EDAM"), which states:

> The "employer" is the qualified taxpayer and may qualify for the hiring credit for leased employees. The employer can be either the leasing company or the subscriber to the leasing company. Generally, the employer can be identified due to the legal obligation to pay the payroll taxes of the employee, and as to who has the right to control and direct the workers (employee's) services.

In addition to the guidance provided above, the EDAM also refers to IRS Publication 15-A (Employer's Supplemental Tax Guide) for further information on the establishment of an employer-employee relationship. Part 1 of Publication 15-A states that under common-law rules "anyone who performs services for you is your employee, if you can control what will be done and how it will be done." However, the publication also contains a specific provision dealing with leased employees, wherein it states:

> Under certain circumstances, a corporation furnishing workers to various professional people and firms is the employer of those workers for employment tax purposes. The service corporation has the right to control and direct the worker's services for the subscriber, including the right to discharge or reassign the worker. The service corporation hires the workers, controls the payment of their wages, provides them with unemployment insurance and other benefits, and is the employer for employment tax purposes.

Given the guidance provided through both the EDAM and IRS Publication 15-A, it would appear that the determination as to which entity in a leasing arrangement is considered the employer for purposes of the hiring credits would depend upon an extensive analysis of the facts and circumstances of each case. In every case, there will be variations in the contractual obligations to be performed by the leasing company and the subscriber company, resulting in differing levels of control over the subject employees from case to case. These differing levels of control will result in differing determinations regarding the identity of the employer for purposes of the hiring credits.

DETERMINATION OF THE EMPLOYING ENTITY AND THE PAYROLL FACTOR

California Code of Regulations, title 18, section 25132 provides the general rule for calculating the payroll factor of the apportionment formula, stating that:

> The payroll factor of the apportionment formula for each trade or business of the taxpayer shall include the total amount paid by the taxpayer in the regular course of its trade or business for compensation during the income year.

California Revenue and Tax Code section 25133 then controls the determination of compensation to be included in the payroll factor by stating that:

Compensation is paid in this state if:

(a) The individual's service is performed entirely within this state; or
(b) The individual's service is performed both within and without the state, but the service performed without the state is incidental to the individual's service within the state; or
(c) Some of the service is performed in the state and (1) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled in this state, or (2) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this state.

When determining the payroll factor for apportionment purposes, the statutes and the corresponding regulations focus on the geographic location of the employees at the time they receive compensation for the services they perform. Given the fact that the focus of the payroll factor calculation is on the employee, the regulation must then define who is to be considered an employee for purposes of the payroll factor. California Code of Regulations, section 25132(a)(4), provides this definition by stating that:

> The term "employee" means (A) any officer of a corporation or (B) any individual who, under the usual common-law rules applicable in determining the employer-employee relationship, has the status of an employee.

While the regulations follow the traditional common-law rules in defining employee, they do not include a definition of employer. A possible explanation for this omission may be that the payroll factor provisions do not concern themselves with the identity of the employer in most cases. The main goal in calculating the payroll factor for purposes of apportionment is to identify the geographic location of the employee, and determine if the compensation is in fact being paid within California. The purpose of referencing the payroll factor for purposes of the credit is to provide a means for determining whether the payroll should be treated as being zone payroll. It was not referenced for purposes of determining whose payroll it is for purposes of the credit.

Given the fact that the payroll factor provisions do not seek to determine the employing entity in most cases, it would be inappropriate to use the rules and definitions applicable in calculating the payroll factor to make the determination of the employing entity. In your letter, you accurately state that the hiring credit provisions require use of the apportionment provisions, commencing with Revenue and Tax Code section 25120, in order to determine the amount of tax

that may be offset by the hiring credits. The apportionment provisions, including Revenue and Tax Code section 25132, are in fact incorporated into the hiring credit provisions; however, this is mainly done to properly apportion business income to the enterprise zone.[1] This establishes the amount of tax that may be offset by the hiring credits. The taxpayer must then determine the employing entity that is to properly receive the credits. This determination is based on an analysis of the facts and circumstances that give rise to a particular employer-employee relationship.

CONCLUSION

Given the fact that the term "employer" for purposes of the hiring credits is not defined in the statutes themselves, we are forced to look to other sources for guidance. The sources discussed above, including both the EDAM and IRS Publication 15-A, seem to encourage an analysis of the facts and circumstances of each particular case to determine the proper employing entity for purposes of the hiring credit. Definitions provided in other statutory schemes incorporated into the hiring credit provisions, such as the apportionment provisions discussed above, may be somewhat useful in a facts and circumstances analysis, but most likely cannot constitute the entire analysis in determining the identity of the employer for purposes of the hiring credits.

This letter is only intended to provide you with an understanding of the statutory framework of the hiring credit provisions. Again, this information is advisory only and the relief provisions of Revenue and Tax Code section 21012, subdivision (a), do not apply.

Sincerely,

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[1] California Revenue and Tax Code sections 23622.7(j)(2) and 23622.7(j)(3).